HB 1377

Department of Legislative Services

Maryland General Assembly
2018 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 1377 (Delegate Morgan, *et al.*)
Ways and Means

Income Tax - Subtraction Modification - Income From Retirement Plans

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This bill allows individuals who meet the qualifications of the existing State pension exclusion (at least 65 years old or meet disability requirements) to exempt a maximum of $15,000 in qualified retirement income. The maximum exclusion allowed is indexed to the maximum annual benefit payable under the Social Security Act and is reduced by the amount of any Social Security payments received.

Qualified retirement income eligible for the subtraction modification includes the following plans or sources: (1) individual retirement accounts (IRAs) and annuities under Section 408 of the Internal Revenue Code (IRC); (2) Roth IRAs under Section 408(a) of the IRC; (3) simplified employee pensions under Section 408(k) of the IRC; (4) salary reduction plans under Section 401(k) of the IRC; and (5) a tax sheltered annuity plan under Section 403(b) of the IRC. **The bill takes effect July 1, 2018, and applies to tax year 2018 and beyond.**

Fiscal Summary

State Effect: General fund revenues decrease significantly beginning in FY 2019 due to additional pension income being exempted. Expenditures are not affected.

Local Effect: Local revenues decrease significantly beginning in FY 2019 due to additional pension income being exempted. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Current Law/Background: Maryland law provides a pension exclusion (in the form of a subtraction modification) for individuals who are at least 65 years old or who are totally disabled. Under this subtraction modification, up to a specified maximum amount of taxable pension income ($29,900 for 2017) may be exempt from tax. The maximum exclusion allowed is indexed to the maximum annual benefit payable under the Social Security Act and is reduced by the amount of any Social Security payments received (Social Security offset).

The "Social Security offset" is the reduction in the maximum pension exclusion allowed under current law for an individual. The Social Security offset was established at the same time as the pension exclusion. Given that Social Security benefits are exempt from Maryland income tax even though benefits are partially taxable for federal purposes, the offset works to equalize the tax treatment of individuals who receive their retirement benefits from different sources by reducing the amount of the allowable exclusion by the amount of any Social Security benefits received.

One significant feature of the current pension exclusion is that it is limited to income received from an "employee retirement system." Chapter 524 of 2000 clarified the definition of an "employee retirement system" by providing for the types of retirement income that may be included for purposes of calculating the pension exclusion. As defined by Chapter 524, eligible employee retirement systems are retirement plans established and maintained by an employer for the benefit of its employees and qualified under § 401(a), § 403, or § 457(b) of the IRC. These include defined benefit and defined contribution pension plans, 401(k) plans, 403(b) plans, and 457(b) plans. However, Chapter 524 also included language clarifying what is not included in an "employee retirement system": (1) an IRA or annuity under § 408 of the IRC; (2) a Roth IRA under § 408A of the IRC; (3) a rollover IRA; (4) a simplified employee pension under § 408(k) of the IRC; or (5) an ineligible deferred compensation plan under § 457(f) of the IRC. Since 2000, there have been no substantive changes to the pension exclusion. **Exhibit 1** shows the eligible and ineligible retirement income under the pension exclusion.

Exhibit 1
Eligible and Ineligible Retirement Plans under the Pension Exclusion

Eligible	Ineligible
• 401(k) Cash or Deferred Arrangement Plans	• Traditional IRAs
• 403(b) Plans	• Rollover IRAs
• 457(b) Plans	• Roth IRAs
• Thrift Savings Plans	• Keogh Plans
• Savings Incentive Match Plan for Employees Retirement Plans under § 401(k) of the IRC	• Simplified Employee Pensions
	• Savings Incentive Match Plan for Employees Retirement Plans under § 408 of the IRC

IRA: individual retirement accounts
IRC: Internal Revenue Code

Source: Department of Legislative Services

Additional retirement income may be exempted if the individual has qualified U.S. military, fire, rescue, or emergency services personnel retirement income.

In addition to the special treatment of Social Security and other retirement income, additional income tax relief is provided to senior citizens regardless of the source of their income. Each individual age 65 and older is allowed a $1,000 personal exemption in addition to the regular personal exemption allowed for all individuals. According to the Department of Budget and Management, in fiscal 2018 the State subtraction modification for Social Security benefits reduced State revenues by $212.5 million (this is in addition to the revenue loss resulting from the partial federal exemption of Social Security benefits), the State pension exclusion reduced State revenues by $167.5 million, and the additional personal exemption reduced State revenues by $30.6 million.

State/Local Revenues: The bill exempts up to $15,000 in qualified retirement income beginning in tax year 2018. As a result, annual State and local income tax revenues will decrease significantly beginning in fiscal 2019.

Due to taxpayer confidentiality requirements, the Department of Legislative Services does not have access to income tax data and is dependent on data from the Comptroller's Office.

As required by Chapter 648 of 2016, the Comptroller's Office altered the personal income tax form to capture additional data on the pension exclusion by adding Form 502R.

Based on a preliminary analysis of this data, the Comptroller's Office estimates that the bill will reduce both State revenues by at least $100 million annually and local income tax revenues by at least $70 million annually.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office; Department of Legislative Services

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